Supreme Court, U.S.
FILED
MAR 9 1994
OFFICE OF THE CLERK

(4)

No. 93-1198

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

IN RE: TIME WARNER INC.
SECURITIES LITIGATION

STEVEN J. ROSS, N.J. NICHOLAS, JR., GERALD M. LEVIN, BERT W. WASSERMAN, and TIME WARNER INC.,

Petitioners,

v.

ZVI TRADING CORP. EMPLOYEES' MONEY PURCHASE PENSION PLAN AND TRUST and BARRY ZONON,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY TO BRIEFS IN OPPOSITION

STUART ROBINOWITZ
(Counsel of Record)
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON
1285 Avenue of the Americas
New York, New York 10019-6064
(212) 373-3000
Counsel for Petitioners

Of Counsel
RICHARD A. ROSEN
ALISA D. SHUDOFSKY

10 pp

TABLE OF CONTENTS

Page(s)

I THE DECISION BELOW ERODES THE RIGOROUS STANDARD FOR PLEADING FRAUDULENT INTENT 2

II THE DECISION BELOW ADOPTS A DISCRIMINATORY STANDARD IN 10b-5 ACTIONS 5

III THE DECISION BELOW UNDERMINES THE NATION'S SECURITIES REGULATORY REGIME 5

CONCLUSION 7

TABLE OF AUTHORITIES

Cases **Page(s)**

Basic Inc. v. *Levinson*, 485 U.S. 224 (1988) . . . . . *Passim*

Blue Chip Stamps v. *Manor Drug Stores*, 421 U.S. 723 (1975) 2, 4

Statutes and Regulations

17 C.F.R. 240.10b-5 . . . . . *Passim*

Federal Rules of Civil Procedure

Rule 9(b) 2, 4

Rule 12(b)(6) 2, 4, 5

No. 93-1198

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

IN RE: TIME WARNER INC.
SECURITIES LITIGATION

STEVEN J. ROSS, N.J. NICHOLAS, JR., GERALD M. LEVIN, BERT W. WASSERMAN, and TIME WARNER INC.,

Petitioners,

v.

ZVI TRADING CORP. EMPLOYEES' MONEY PURCHASE PENSION PLAN AND TRUST and BARRY ZONON,

Respondents.

REPLY TO BRIEFS IN OPPOSITION

The two opposition briefs[1] deny that the Second Circuit rejected the efficient market theory adopted in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), and its progeny.[2] But the

---

[1] Lead counsel for respondents filed a brief (herein referred to as "ZVI Br."). Respondent Zonon filed a separate brief ("Zonon Br."). The two briefs disagree on key points.

[2] Respondents assert that "the Second Circuit actually embraced the efficient market theory" (ZVI Br. n.7); "the motive theory accepted by the Second Circuit explicitly recognizes that material information is efficiently impounded by the securities markets" (*id.* 17); the decision "is entirely consistent with the efficient

(continued...)

majority opinion, refusing to follow *Basic*, declared that "confidence in the efficient markets hypothesis is not universally shared"; and that "the laws of economics have not yet achieved the status of the law of gravity" (Pet. 32a, 33a). Judge Winter, in a vigorous dissent, noted that "my colleagues suggest that the efficient market hypothesis is flawed," and he criticized the majority's "skepticism about the usefulness of the efficient market hypothesis" (Pet. 40a, 41a).

The Second Circuit's rejection of *Basic*'s efficient market doctrine—conflicting with at least seven other circuits (Pet. 11)—raises three issues that merit plenary review.

First: By departing from *Basic*, the decision erodes Rule 10b-5's requirement that a plaintiff plead a *rational* theory of fraudulent intent. The decision will encourage vexatious suits based on far-fetched scienter scenarios that make no economic sense, contrary to the policies of *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), and Rule 9(b).

Second: The decision adopts a discriminatory standard. A securities fraud plaintiff may rely on the efficient market theory (and its fraud-on-the-market corollary) as a proxy for pleading reliance, but a defendant may not invoke the same theory to challenge an irrational scienter pleading under Rule 12(b)(6).

Third: The decision below injects unwarranted and destructive uncertainty into the nation's securities regulatory regime, which is based on *Basic*'s efficient market principle.

---

[2](...continued)
market theory" (*id.* 25); "there is little controversy about the existence of an efficient market" (Zonon Br. n.12); and "[t]here is wide agreement that market prices reflect available information" (*id.* 13).

I

THE DECISION BELOW ERODES THE RIGOROUS STANDARD FOR PLEADING FRAUDULENT INTENT

The majority opinion accepted respondents' theory that TW might have briefly delayed disclosing consideration of a possible rights offering in the hope it could obtain an inflated price per share after the transaction was announced. But, as demonstrated by Judge Winter (Pet. 38a-42a) and the petition (pp. 8-11), sophisticated businessmen, advised by Wall Street experts, could not rationally have believed that the stock market would fail to reflect—promptly and fully—the announcement of a multi-billion dollar rights offering by a high-profile company. The stockholders had ample time (more than a month) to observe the stock market's reaction and changes in the price of TW's shares before deciding whether to exercise rights and buy additional stock.

Respondents' briefs, significantly, do not suggest—nor do their complaints allege—the existence of any "bubbles" or other imperfections in the market for TW's stock that would have prevented the market from fully impounding the news of the rights offering in the price of TW's shares. That is not surprising because respondents' complaint stresses that the market for TW's stock operates very efficiently (Pet. 6 n.4); and their present briefs emphasize that the market reacted, sharply and swiftly, to the rights offering announcement (ZVI Br. 7-8; Zonon Br. 4).

Respondent ZVI (but not Zonon) suggests that the dynamics of the alleged "coercive rights offering" (Br. 31)—an offering in which the price would fluctuate between $63 and $105 per share depending on the number of rights that were exercised—might somehow create a "bubble." That theory, not relied on by the

majority opinion, was properly rejected by Judge Winter.[3/] Regardless of whether the price at which shares were offered to the public was fixed or variable, all information about the terms of the proposed rights offering would be impounded in the market price of the stock for at least a month before an investor had to decide what to do. Under such circumstances, the *timing* of disclosure, as Judge Winter pointed out (Pet. 38a-39a), could not possibly have affected the range of prices which investors would eventually pay—and it would be wholly irrational to think otherwise.

Respondents argue that it is premature to grant certiorari because the scienter issue arose on a Rule 12(b)(6) motion to dismiss the complaint. But most securities fraud lawsuits are met with motions to dismiss, and a high percentage fail to survive the threshold challenge. Since the lower courts are constantly required to examine the sufficiency of scienter allegations, it is critical that there be rational standards; indeed, Rule 9(b) sets particularly high pleading standards in 10b-5 cases to prevent strike suits (Pet. 11 n.7).

Vexatious 10b-5 complaints should be dismissed at the outset, *before* plaintiffs can exploit "the litigation process as a device for extracting undeserved settlements as the price of avoiding the extensive discovery costs that frequently ensue once a complaint survives dismissal, even though no recovery would occur if the suit were litigated to completion" (Pet. 19a). That is the teaching of *Blue Chip*, 421 U.S. at 739 ("There has been widespread recognition that litigation under Rule 10b-5 presents a

---

[3/] Judge Winter explained that to the extent that stockholders perceived the offer to be coercive, this would increase the market's swift and negative reaction to the announcement of the rights offer, whenever the announcement was made (Pet. 38a-39a). He declared: "The notion that the existing shareholders would continue to rely upon long-gone statements regarding fresh capital in the face of the coercive rights offering is entirely far-fetched" (*id.* 39a); the scienter "scenario is wholly implausible in light of the nature of the variable-price rights offering" (*id.*); and "[t]he variable-price rights offering was... very bad news, but the timing of the announcement seems rather irrelevant" (*id.* 38a).

danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.").

Finally, respondents claim that review by this Court "would be premature because plaintiffs may amend their complaint to assert an alternative theory of scienter" (ZVI Br. 39). That is a frivolous argument because it is always theoretically possible for plaintiffs to amend. That is no reason to refrain from reviewing an important issue of securities law that was incorrectly decided by the Second Circuit. The decision below should be corrected now because it eviscerates Rule 10b-5's strict requirement for pleading a rational theory of fraudulent intent and will stimulate a flood of strike suits based on implausible scienter scenarios.

II

THE DECISION BELOW ADOPTS A DISCRIMINATORY STANDARD IN 10b-5 ACTIONS

As demonstrated by Judge Winter (Pet. 41a) and the petition (pp. 12-13), the court below adopted a double standard in 10b-5 actions—it allows a plaintiff to rely on the efficient market theory (and its fraud-on-the-market corollary) as a proxy for pleading reliance, but precludes a defendant from invoking that same theory under Rule 12(b)(6) to challenge scenarios of fraudulent intent that make no economic sense.

Respondent Zonon (but not ZVI) strenuously strives to support the double standard (Br. 6, 7, 12, 16). He contends, without explanation, that "the elements of reliance and scienter are treated discretely" (*id.* 13); that "[t]he second circuit's segregation of scienter from reliance was . . . routine procedure" (*id.* 7); and that "[w]e acknowledge the efficiency of the market" for the element of reliance, but for purposes of scienter "[w]e posit only the value ascribed to an item of information cannot be precisely quantified by reference solely to the pleadings" (*id.* n.19).

Those *ipse dixit* arguments highlight the unprincipled nature of the double standard created by the decision below.

III

THE DECISION BELOW UNDERMINES THE NATION'S SECURITIES REGULATORY REGIME

As demonstrated by Judge Winter (Pet. 39a-40a) and the petition (14-16), the Second Circuit's erosion of *Basic*'s efficient market theory threatens seriously to undermine the nation's securities regulatory regime and destabilize well-settled legal principles upon which market participants traditionally rely. Respondents, significantly, ignore this point entirely.

By encouraging litigation based on imaginary "bubbles" in efficient markets for widely-traded securities, the decision below injects a new element of uncertainty where before the law was clear. The decision, if not reversed, will create confusion among market participants and encourage vexatious 10b-5 suits based on far-fetched scienter theories. These are compelling grounds for plenary review by this Court.

Conclusion

For the reasons demonstrated herein and in the petition, the Court should grant the petition for a writ of certiorari.

Dated: March 8, 1994

Respectfully submitted,

STUART ROBINOWITZ
(Counsel of Record)
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON
1285 Avenue of the Americas
New York, New York 10019-6064
(212) 373-3000

Counsel for Petitioners

Of Counsel

Richard A. Rosen
Alisa D. Shudofsky